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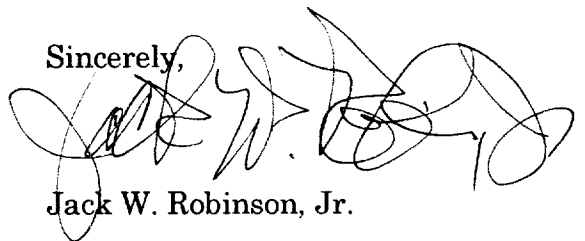
David Waddell
Executive Secretary
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243

In Re: Reconsideration of the Requirements on Local Exchange
Companies Adopted in Docket U-87-7492, Docket No. 01-00799

Dear Mr. Waddell:

Please find enclosed for filing the original and 13 copies of the Comments of AT&T in the above-captioned proceeding. Thank you for your assistance in this matter.

Sincerely,



Jack W. Robinson, Jr.

Encls.

**BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE**

IN RE:

**RECONSIDERATION OF THE REQUIREMENTS)
ON LOCAL EXCHANGE COMPANIES ADOPTED)
IN DOCKET U-87-7492)**

Docket No. 01-00799

COMMENTS OF AT&T

AT&T Communications of the South Central States, Inc. (AT&T), pursuant to the Notice of Filing issued by the Tennessee Regulatory Authority (TRA) on September 27, 2001, files these comments seeking the elimination of the thirteen (13) year old annual "Megacom Adjustment". The basis for the Megacom Adjustment no longer exists, and its continued application results in unjust, unreasonable and discriminatory Common Carrier Line Charges ("CCLC"). This is particularly true for those incumbent local exchange telephone companies that are increasing their CCLC's pursuant to the Megacom Adjustment formula while at the same time earning in excess of their fair rate of return. It is neither just nor reasonable to compel interexchange carriers (IXCs) and Tennessee consumers to pad the profits of those incumbent local exchange telephone companies. In order to understand the Megacom Adjustment, it is necessary to trace its origin, basis and development.

THE ORIGIN, BASIS AND DEVELOPMENT OF THE MEGACOM ADJUSTMENT

The Megacom Adjustment originated in the Megacom Order entered by the Tennessee Public Service Commission ("TPSC") on March 17, 1988, in Docket No. U-87-7492, *In Re Tariff Filing By AT&T Communications To Establish Rates and Charges For Megacom and Megacom 800 Services*. Dockets regarding similar tariff filings by U. S. Sprint and MCI Telecommunications were consolidated for investigation and hearing together with AT&T's filing.

A copy of that Order is attached as Exhibit 1 to these Comments. South Central Bell (now BellSouth), United Inter-Mountain Telephone Company, the Tennessee Telephone Association, and the Memphis Cellular Telephone Association were granted intervention.

The Megacom Order included a comprehensive review and reaffirmation of the TPSC's then-existing policies: (i) the prohibition of intraLATA toll competition; (ii) the recognition that competition would require the setting of cost based rates for intraLATA toll services; and (iii) the maintenance of essentially the same level of contribution from toll services to local services as existed prior to divestiture, i.e., prior to January 1, 1984. At the same time the TPSC recognized the benefit to large users of toll services resulting from the approval of Megacom services and the need to reduce access charges. The TPSC voted to approve the Megacom tariffs subject to two conditions.

The first condition was that the IXC's had to charge the same or a higher rate per minute as the average WATS rate for an intraLATA call. The Order stated, at page 13:

Based on Bell's current WATS tariff, this means that all the petitioners must charge at least 18 cents per minute on outWATS services and 19.5 cents per minute on inWATS (800) services to any customer who makes an intraLATA call using one of the proposed, special access services. (Footnote omitted).

The second condition was adopted to assure that these new services did not result in lower toll costs for large volume users at the expense of local ratepayers. The IXC's were required to pay: (i) interLATA access charges associated with the completion of interLATA calls; and (ii) compensation to the LECs for the completion of intraLATA calls.

The Megacom Order made no change in the then-existing system for intraLATA compensation (page 18). However, with respect to interLATA access charges, the TPSC adopted a new system, the annual "Megacom Adjustment". The TPSC stated the basis of the new system at pages 16-17:

The Commission designed the access charge system to maintain, at pre-divestiture levels, the relative balance between the price of intrastate toll calls and local service rates. In practice, however, the system is gradually forcing long distance customers to pay an increasingly larger share of the total costs of telephone service.

Over the last four years, interLATA toll usage has increased at an annual rate of 12% to 15%. During the same time, the total number of telephone subscribers (measured by the number of LEC access lines) has grown at a rate of only 3.5% to 4%. Since access charges are paid by the minute, LEC access revenues have been growing much faster than the number of LEC subscribers; in other words, the contribution collected from toll users to support local rates is growing faster than the number of local ratepayers. As these trends continue, local rates may shrink but only at the increasing expense of long distance customers. Tr. II, 413-414.

Following meetings between the parties, the TPSC staff recommended the interLATA access charge plan described within the Appendix to the Order. In approving the plan, the TPSC stated, at pages 17-18:

In summary, the plan requires each LEC to adjust annually its Common carrier Line Charge to maintain a fixed amount of access revenue per LEC access line. As long as toll minutes continue to increase faster than access lines, the plan will result in annual reductions in intrastate rates for switched access.

The TPSC concluded its discussion of this issue, at page 18:

Adoption of this plan does not foreclose the Commission from ordering further changes in the CCLC rates or AT&T's long distance rates as the result of other regulatory proceedings.¹

¹ At the time of the Megacom Order, AT&T remained subject to rate base rate of return regulation. At that time the rates of other IXC's were not regulated, except that they could not exceed AT&T's rates.

The Megacom Adjustment formula, as stated in the Appendix to the Megacom Order provided: (i) each year each LEC would reduce its CCLC rates by the amount its access minutes of use ("MOU") growth rate exceeds the growth rate of its access lines for the prior twelve months ended June 30; (ii) if the access lines growth rate exceeds the MOU growth rate, the CCLC would be increased; (iii) in lieu of this methodology, a LEC could propose a change in the CCLC as part of a rate filing; (iv) the adjusted CCLC rate could not be reduced below the interstate CCLC rates; (v) procedures to be followed in implementing the adjustment were adopted; and (vi) a statement was included that the TPSC intended to conduct an in depth review of the plan no later than January 1, 1992.

The CCLC and the Megacom Adjustment were, therefore, never intended to be a long-term, much less a fixed, system, but were recognized as an interim measure that would need to be changed as circumstances changed. They were not adopted pursuant to any review of the revenue needs, or costs, of any particular LEC, but rather were adopted as a condition imposed on the IXCs for providing service under Megacom tariffs in an IXC Megacom tariff proceeding. They were an aspect of the TPSC's then-policies: (i) to prohibit intraLATA competition and thereby preserve value of service pricing (and avoiding cost-based rates which the TPSC recognized competition would require); and (ii) to continue essentially the same level of contribution from interLATA toll to local service as existed prior to divestiture, i.e., prior to January 1, 1984. The Megacom Adjustment was prompted by the experience of the previous four years where interLATA toll usage had been increasing at a much higher rate than growth in access lines, resulting in a shifting of costs from local to toll. The TPSC expressly recognized that adoption of this plan did not foreclose further changes in CCLC rates and that the plan needed to be reviewed in depth.

The TPSC, however, never completed an in depth review of the Megacom Adjustment plan. The proper construction of the plan in accordance with its intent was an issue in Docket No.

89-15385, Order entered February 20, 1990, *In Re: Tariff Filing By South Central Bell Telephone Company To Reflect The Annual CCLC Adjustment* (copy attached as Exhibit 2). The dispute in that matter arose because on January 1, 1989, the TPSC had reduced to zero South Central Bell's CCLC on the originating end of WATS calls and on the terminating end of 800 calls. South Central Bell interpreted the Megacom formula in a manner having the effect of shifting to other toll customers the CCLC formerly paid by WATS and 800 customers. South Central Bell's interpretation was consistent with the literal language of the Megacom formula, but was inconsistent with its intent. The TPSC ordered a modification of South Central Bell's tariff to reflect that intent. The TPSC explained the purpose of the Megacom formula, at page 2:

The purpose of the Megacom formula was to "cap" CCLC revenues per LEC access line. To accomplish that result, the formula stated that each LEC should make an annual adjustment in its CCLC based on the difference, if any, between the growth rate in intrastate toll minutes and the growth rate in LEC access lines. The Megacom decision also recognized that the Commission might adjust the CCLC in the course of other rate proceedings. Those rate adjustments might increase or decrease the "cap." (Footnote omitted).

On January 4, 1993, the staff of the TPSC reported to the Commissioners the result of a task force study, recommending that intrastate access charges move to interstate levels. The task force was made up of representatives of the LECs and the IXC's. The task force report stated that:

The companies agreed that cost should serve as the price floor for access charges *and that access charges should be based on cost*. No company specified exact prices above the cost floor. The majority of the companies did think that moving intrastate access rates to the interstate level should be the first step in setting cost based access rates. (Emphasis added).

On August 20, 1993 in the South Central Bell earnings investigation for 1993-1995, Docket No. 92-13527, the TPSC stated, at p. 16:

The Commission finds that it is in public interest to reduce South Central Bell's access rates by an amount that will allow long distance companies to reduce their toll rates to interstate levels, and to reduce South Central Bell's toll rates consistent with the method used to reduce toll rates in Docket 89-11065. This action continues the Commission's consistent practice of reducing toll rates to all Tennessee customers and moving access rates closer to parity with interstate rates. The Commission intends to continue this practice as appropriate opportunities present themselves.

No similar reductions have been made in the access charges of the independent LECs, which have continued to file yearly Megacom tariff adjustments that have generally been routinely approved.

By Chapter 408 of the Public Acts of 1995, the Tennessee General Assembly adopted a substantial revision in the regulation of telecommunications service providers, including incumbent local exchange telephone companies. Among the provisions of that Act, under T.C.A. §65-5-209, incumbent local exchange telephone companies may elect to adopt price regulation plans for the setting of their rates. BellSouth Telecommunications, Inc. ("BellSouth") and United Telephone Southeast ("UTSE") promptly filed applications to come within a price regulation plan, which applications were eventually granted. On December 31, 1997, UTSE filed a Petition for a Declaratory Order contending that the Megacom adjustment no longer applied to it pursuant to its price regulation plan and the governing statute. BellSouth intervened in support of UTSE's position. The TRA concluded on November 24, 1998, at page 4 of its Order in that proceeding:

Upon consideration of the Petition for Declaratory Order and the record in this matter the Directors determined that Tenn. Code Ann. §65-5-209(g) read together with Tenn. Code Ann. §65-5-209(h) and other provisions of Tennessee law supersede the access rate adjustments required by the Megacom Order. Further, on November 12, 1996, United implemented toll dialing parity removing restrictions on intraLATA competition, a fundamental basis for implementing the required annual access rate adjustment in the Megacom Order. Therefore, the Directors determined that as a price regulated entity and the Petitioner in this matter, United is no longer subject to the Megacom Order. The Directors unanimously approved United's Petition for Declaratory Order.

A copy of the TRA's Order, without exhibits, is attached as Exhibit 3 to these Comments.

BellSouth continues to be by far the largest provider of local exchange, including access, service in Tennessee; and it has substantially reduced its access charges. UTSE also provides local exchange, including access, services, to a significant number of Tennessee customers. The access charges to be paid by AT&T and other IXC's to BellSouth and UTSE, no longer are fixed by, or subject to, the Megacom Adjustment. The result is that AT&T and its customers continue to pay CCLCs based on the Megacom Adjustment only to the independent LECs; and those CCLC rates are far in excess of those charged by BellSouth.

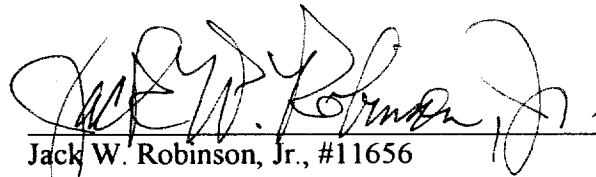
THE CHANGES IN THE BASIS FOR THE MEGACOM ADJUSTMENT

No extended discussion is necessary to demonstrate that the basis for imposing conditions on the approval of the Megacom tariff, including the Megacom Adjustment, are no longer relevant to today's facts. None of those conditions, including the Megacom Adjustment, was intended to be a long term, much less a fixed, system. With the advent of dialing parity, competition in the intraLATA toll market, including the markets of the independent LECs, is a reality and the TPSC's policy of prohibiting intraLATA toll competition is no longer valid. As the TPSC repeatedly recognized, value of service pricing is inconsistent with competition. Thus, Megacom Adjustment is value of service pricing. No rational basis whatever exists for continuing to require IXC's to pay a contribution from interLATA toll to local service based on a rate structure in existence prior to divestiture. No relationships between the specific revenue needs or costs of providing access service for each incumbent local exchange telephone company has ever been demonstrated. Under today's circumstances, the continued imposition of that contribution is purely arbitrary. The Megacom conditions were imposed primarily on the basis of South Central Bell's rate structure, as the Megacom Order reflects, and with the advent of price regulation for BellSouth, that primary

basis is no longer relevant, leaving an unjustly discriminatory pattern between the access charges paid ultimately by consumers in BellSouth's service area and consumers in the service areas of the independent LECs. The purpose of the Megacom Adjustment was to cap CCLC revenues per LEC access line. The Megacom Order itself recognized, as the TPSC emphasized in its February 20, 1990, Order modifying South Central Bell's Megacom Adjustment tariff, the Commission could, and did, adjust South Central Bell's CCLC in the course of other proceedings, which adjustment could increase or decrease that cap. No rational basis exists for continuing to maintain that obsolete system. The continued reliance on the Megacom Adjustment, especially to justify increases in clearly excessive CCLCs, is inconsistent with the intent of the Megacom Order establishing that system. The level of access charges, including the CCLCs, should be placed on a rational, cost based basis for each LEC remaining under rate base rate of return regulation.

AT&T recognizes that the ultimate determination of a proper level of general access charges includes issues to be determined in other proceedings before the TRA, including universal service and access charge reform. However, no basis exists for delaying to remedy the continued injustice of the CCLC charges resulting from the obsolete Megacom Adjustment – particularly for those companies increasing their CCLC charges, which are earning in excess of their current authorized fair rates of return. Consequently, based on the foregoing reasons, the TRA should eliminate the annual "Megacom Adjustment".

Respectfully submitted this 17th day of October 2001.

A handwritten signature in black ink, appearing to read "Jack W. Robinson, Jr.", is written over a horizontal line.

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BEFORE THE TENNESSEE PUBLIC SERVICE COMMISSION

March 17, 1988

Nashville, Tennessee

IN RE: TARIFF FILING BY AT&T COMMUNICATIONS
 TO ESTABLISH RATES AND CHARGES FOR
 MEGACOM AND MEGACOM 800 SERVICES

DOCKET NO. U-87-7492

TARIFF FILING BY U. S. SPRINT TO ESTABLISH
RATES AND CHARGES FOR ULTRAWATS

DOCKET NO. U-87-7512

TARIFF FILING BY MCI TELECOMMUNICATIONS TO
ESTABLISH RATES AND CHARGES FOR 800 SERVICE

DOCKET NO. U-87-7513

TARIFF FILING BY MCI TELECOMMUNICATIONS TO
ESTABLISH RATES AND CHARGES FOR PRISM I AND
PRISM II

DOCKET NO. U-87-7514

TARIFF FILING BY U.S. SPRINT TO ESTABLISH
RATES AND CHARGES FOR DIRECT 800 AND ULTRA
800 SERVICE

DOCKET NO. U-87-7515

O R D E R

This matter is before the Commission as a result of the consolidation of several similar tariff offerings by interexchange carriers (IXCs). On February 23, 1987, AT&T Communications of the South Central States filed tariff proposals for its Megacom and Megacom 800 services. On May 18, 1987, U.S. Sprint filed tariff proposals for its UltraWATS and Ultra800 services. On June 24, 1987, MCI filed tariffs for its Prism I, Prism II, and 800 services.

EXHIBIT

1

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Because all of the proposed services operate similarly and raise common regulatory issues, the Commission consolidated all the petitions for investigation and hearing. The agency granted petitions to intervene filed by South Central Bell Telephone Company, United Inter-Mountain Telephone Company, the Tennessee Telephone Association, and the Memphis Cellular Telephone Association.

The agency heard evidence on September 3 and 4, 1987, Commissioners Cochran, Hewlett and Bissell presiding. The Commissioners deliberated on the matter during a regularly scheduled public conference on March 15, 1988. At that time, the Commissioners voted to approve the proposed services subject to the conditions described in this Order. In support of that decision the Commission issues this Order and makes the following findings of fact and conclusions of law.

I. THE PROPOSED SERVICES

The tariffs at issue have been variously described as high capacity, bypass, direct connection, or WATS-like telephone services. Each description is accurate, in part. In general terms, the new services offer large customers a more efficient, cheaper, and convenient means of making long distance telephone calls.

The new services are technically more efficient because large customers may concentrate their outgoing or incoming calls over a few, high capacity lines that directly connect the customer to an IXC switch.

The new offerings are cheaper because they are designed to bypass, at either the originating or terminating end of a call, the switching facilities of the local exchange telephone company ("LEC") and the associated switching charges which would otherwise have to be paid to the LEC. Those charges are fixed by this Commission and are intended to contribute to the costs of maintaining the local telephone network.¹ By circumventing these charges, the petitioners can offer telephone services to high volume customers at a substantially reduced rate. Tr. I, 88, 256-257, 289, Tr. II, 260, 316.

For example, AT&T's "Megacom" service requires each subscriber to build, buy, or lease a line connecting the customer's premises directly to the nearest AT&T switch, bypassing the facilities of the local exchange carrier. The subscriber may build his own link, such as a microwave system or - more typically - may lease a high capacity "special access line" from the local exchange carrier.² The special access line is "hardwired"; it does not pass through the LEC's switching facilities and is used solely for that customer's long distance calls.

1/ The development and purpose of these switched access charges is described in a series of Orders issued in 1984 and 1985 in Docket U-83-7261, Investigation Concerning Intrastate Access Charges. See also Petition of MCI Telecommunications Corporation, Docket U-84-7311, Orders of November 26, 1984, March 6, April 19, August 30, October 21, and October 31, 1985.

2/ Under present allocation procedures, the FCC assigns all LEC revenues and costs associated with these lines to the interstate jurisdiction; therefore these connections provide no contribution to the costs of maintaining the intrastate network. Tr. II, 260.

Megacom is expensive to install, but the long-run savings are substantial. A subscriber must purchase a connecting line to the AT&T switch and also pay the carrier a large monthly fee. Once the service is installed, however, the subscriber can use it to call anywhere in Tennessee (even another telephone in the same local exchange) at an average cost of 16 cents a minute, much less than the price of an ordinary long distance call or AT&T's WATS service. MCI's "Prism" and Sprint's "UltraWATS" tariffs operate the same way but are priced a few cents per minute less than Megacom.

Finally, the proposed services are convenient because they provide customers with the opportunity to choose one carrier to handle all the customer's long distance calls. Since the court-ordered breakup of the Bell system in 1984, Tennesseans have been required to use a local telephone company to make toll calls within a LATA³ and an interexchange carrier to place calls from one LATA to another. In most parts of the State, the LECs are able to screen all toll traffic and route each call to the

3/ By the terms of the court-approved, consent decree ordering the break-up of AT&T telephone network, the regional Bell companies are generally limited to providing telephone service within and around the nation's metropolitan areas. Each such area is called a LATA (Local Access and Transport Area). Tennessee is divided into five LATAs: Memphis, Nashville, Chattanooga, Knoxville, and the Tri-Cities area. South Central Bell is prohibited by the decree from providing toll service from one LATA to another. United States v. Western Electric, 552 F. Supp. 131 (D.D.C. 1982) aff'd sub nom, Maryland v. U.S., 103 S. Ct. 1240 (1983). The petitioners are all certified to provide interstate and interLATA service in Tennessee but are not authorized to complete intraLATA calls.

appropriate carrier. But calls made over Megacom and the other new services bypass the LEC switches, and the petitioners unanimously contend that their own equipment cannot separate intra- from interLATA calls.⁴ Tr. I, 107, 123-124, Tr. II, 404-406 (AT&T); Tr. I, 211, 229, 247-251 (MCI); Tr. I, 361, 411-413 (Sprint). Therefore, under the proposed tariffs, any Megacom, Prism, or UltraWATS customer will be able to place all his toll calls through one carrier and will no longer need to use the intraLATA toll services of a local exchange company.

II. THE REGULATORY FRAMEWORK

To judge the merits of the proposed tariffs, it is necessary to place the issues in context by summarizing briefly the Commission's regulatory policies in this area. The policies were developed and announced in a series of orders issued in 1984 and 1985 to establish a framework for the regulation of intrastate telephone service in the post-

4/ Each petitioner has been authorized by the Federal Communications Commission to provide these services to customers for the purpose of making interstate calls, and all three IXCs have been actively marketing these interstate services in Tennessee. AT&T, however, is the only one which has programmed its system to prevent Megacom customers from making intrastate calls until this Commission authorizes such service. Tr. I, 64-66, 123-124. MCI and Sprint, on the other hand, admitted at the hearing that their Tennessee customers are already using Prism and UltraWATS to complete intrastate calls and that, in some cases at least, MCI and Sprint salesmen have improperly represented to Tennessee customers that these services were available for both interstate and intrastate use. Tr. I, 223, 241-243, 246-247, 363, 379-380.

divestiture period. All three petitioners participated in some or all of these proceedings.⁵

The Commission has adopted the following principles:

1. The introduction of competition among telephone companies should not result in rate increases for Tennesseans. See Docket U-83-7261, Investigation Concerning Intrastate Access Charges, Order of October 21, 1985, at 6.

2. InterLATA competition among IXCs serves the public interest as long as the toll carriers pay a fair portion of the costs of operating the local exchange network. See Docket U-84-7311, Petition of MCI, Order of November 26, 1984, at 5 and Order of April 19, 1985, at 7.

3. IntraLATA competition between IXCs and the local telephone companies would likely result in higher rates for residually-priced LEC services and is therefore prohibited. IntraLATA toll and local exchange service has been and should continue to be provided solely by the LECs. Docket U-84-7311, supra, Order of April 19, 1985, at 3-4.

4. Facilities-based, interexchange carriers may obtain, subject to certain conditions and limitations, certificates to provide interLATA toll service in Tennessee. As the dominant interexchange carrier and provider of last resort, AT&T remains subject to rate base regulation and may

5/ In addition to the dockets and orders cited in footnote 1, see Petition of AT&T for Intrastate Authority, Docket U-83-7266; and the petitions of G.T.E. Sprint and U.S. Telephone for intrastate authority, Dockets U-84-7326 and U-84-7324.

not increase rates without Commission approval. All other IXC's may establish rates at will provided the rates are statewide and non-discriminatory. Id. at 7-11.

5. All interexchange carriers must pay intrastate access charges to the local exchange companies "to replace, in full" the contribution formerly received by the local carriers from intrastate toll calls. Docket U-83-7261, Order of March 4, 1985, 7-12. Those access charges are intended to contribute to local exchange revenues "at least at the same level that such a contribution existed prior to divestiture." Id. The charges "are not now, and have never been, based on the costs" of providing access connections. Id. See also Order of October 21, 1985, 6-9; Tr. II, 315.

6. If an interexchange carrier cannot prevent its customers from completing unauthorized, intraLATA calls, the carrier must reimburse the local exchange companies for their lost toll revenue. Order of March 6, 1985, at 3-4; Order of August 30, 1985, at 2-5, 9.

7. Based on the level of intraLATA toll rates and interLATA access charges in effect at the time of the Commission's decision (August, 1985), the Commission determined that the payment of intrastate access charges would approximately reimburse the local exchange carriers for revenue lost as a result of the completion of unauthorized, intraLATA calls. The goal of the compensation plan was for the LECs to "break even." Order of October 21,

1985, at 3-4. In making that calculation, the Commission assumed that the interexchange carrier would pay switched access charges at both the originating and terminating end of an intraLATA call. Docket U-83-7261, Order of August 30, 1985, at 1-4,9 and see late-filed AT&T exhibit; see also Tr.II, 15-16, 217-219.

8. Resellers are not required to obtain a certificate but must subscribe to appropriate services, accurately report intrastate traffic, and pay access charges in the same manner and at the same rate as facilities-based, interexchange carriers. Docket U-83-7261, Order of August 30, 1985, at 9-11.

9. As a matter of policy, the Commission intends to reduce gradually the level of intrastate access charges in order to encourage efficient use of the exchange network. Docket U-83-7261, Order of March 4, 1985, at 5-6.

The proposed services threaten these policies in two fundamental respects.

First, the services bypass, either at the originating or terminating end, switched access charges which are intended to provide a contribution to local exchange rates.

Second, even if the Commission resolves the contribution problem, these services intrude into the intraLATA market, may threaten LEC toll revenues and raise difficult regulatory issues which go beyond the scope of

this proceeding. Without reliable cost studies to fix the price of LEC services and appropriate safeguards to prevent the local carriers from using monopoly profits to cross-subsidize their competitive services, intraLATA competition threatens "value of service" pricing and potentially creates serious antitrust issues.

III. REASONS FOR APPROVAL

Despite these reservations the Commission has determined that the proposed services should be approved subject to certain restrictions which we are imposing in order to address the problems of LEC compensation and competition.

As previously discussed, these services are designed to handle the high volume telecommunications requirements of large business customers. No one has disputed the IXCs assertion that the most efficient means of handling a large volume of toll calls is to install a high capacity line from the customer's premises directly to an IXC's switch. Tr. I, 356-357, Tr. II, 350-351. To the extent those efficiencies can be passed on to customers, approval of the proposed tariffs will reduce the cost of toll calls and encourage high volume users to continue using the public network. See Tr. I, 18; Tr. II, 69-84. Furthermore, these digital, direct-connection offerings provide customers with the ability to manage their calling patterns and generally provide them a higher quality of telephone service than is available through switched

connections. Tr. I, 88-89. Regulatory restrictions which prevent telephone customers from making the best and most efficient use of available technology are not in the public interest, difficult to enforce and, in the long run, increase the cost of all telephone services. Tr. I, 209, 357. Therefore, the Commission approves the proposed tariffs subject to the conditions discussed in Parts IV and V of this Order.

IV. INTRALATA COMPETITION

The first major issue before us is the impact of the proposed services on the intraLATA toll market. The Commission concludes that the best way to enforce its policy prohibiting intraLATA competition is to require that each of the IXCs before us charge the same price for an intraLATA call as the average WATS rate charged by the LECs.

The Commission reaffirms its opposition to intraLATA competition.⁶ As the agency concluded three years ago, "Competitive intraLATA services would unquestionably reduce the revenue stream to local exchange companies"

^{6/} Despite the fact that the proposed services are being used and will continue to be used to complete intraLATA calls, neither AT&T, Sprint, or MCI has directly asked the Commission to change its policy prohibiting intraLATA toll competition. None of the IXCs before us is authorized to provide intraLATA service and none has requested that its certificate be amended to permit such calls. All three disclaim any intention of using the proposed services to compete with the local exchange carriers in the intraLATA markets and point out that Megacom and the other new offerings are intended for interstate and interLATA usage. They describe any intraLATA calls which their customers might make as an "incidental," "complimentary," or "add-on" service. Tr. I, 6, 7, 37, 39, 41, 74, 176 (AT&T); Tr. I, 202-203, 217, 232 (MCI); Tr. I, 351, 419, Tr. II, 51 (Sprint).

resulting eventually in "higher local service rates."

Petition of MCI Telecommunications Corporation, Docket U-84-7311, April 19, 1985, at 3-4.

✓ Rates charged by local exchange carriers are not cost-based. Although the Commission may consider cost-of-service evidence in setting utility rates, the agency relies primarily upon "value of service" or "intrinsic value" principles in balancing the interests of various customer classes. Policy concerns, not debates over cost recovery, ultimately determine the outcome of rate design issues. See C. F. Industries v. Tenn. Pub. Serv. Comm., 599 S.W. 2d 536, 542 (1980). ✓

Competition and value of service pricing are not compatible. ✓ As explained by MCI's witness, Dr. Steven Brenner, the introduction of competition in the intraLATA market would require the Commission to calculate the underlying "cost" of LEC toll and access services and set cost-based rates for those services. Tr. I, 283-298. As Dr. Brenner conceded, the determination of LEC costs, the separation of a LEC's competitive offerings from its monopoly services, and the comparison of LEC toll rates to IXC rates raise a number of "tricky" and far-reaching regulatory problems. Tr. I, 311-317, 342, 345-346.⁷ Even if the Commission were inclined to reopen the competition

^{7/} Because of these regulatory problems--especially the dangers of cross-subsidy from monopoly services--Dr. Brenner testified that he does not believe the Bell companies should be permitted to compete with the IXCs in the interLATA toll market. Id., at 311.

issue, there is insufficient evidence in this record to consider all the implications of such a change. As the witness for U.S. Sprint testified, "The Commission cannot and should not try to decide that issue in this case. You simply do not have enough evidence in this case to reach a decision on that issue." Tr. I, 372; See Tr. II, 301-302.

In light of this policy prohibiting intraLATA competition, the Commission finds that the IXCs must either prevent subscribers to the new services from completing intraLATA calls or increase the price of such calls to minimize their competitive impact.

/ AT&T, Sprint, and MCI contend that it is either economically or technically impractical to separate and block intraLATA calls. See Part I, supra. The LECs questioned that testimony but offered no competent evidence on the blocking issue. Based on the record before us, the Commission finds that there is insufficient data to determine whether or not intraLATA blocking can be accomplished at a reasonable price without affecting interstate calls. The Commission, however, will not pursue the blocking issue further at this time. We have concluded that there is a more practical and enforceable method of allowing petitioners to offer their new services without introducing intraLATA competition./

As a condition of approving the proposed tariffs, the Commission directs that all certified "competitors" in the intraLATA toll market charge the same rate to high

volume customers.⁸ Each of the IXC's before us may offer its new services to Tennessee customers on a statewide basis only if the petitioner charges the same (or a higher) rate per minute as the average WATS rate for an intraLATA call. Based on Bell's current WATS tariff, this means that all the petitioners must charge at least 18 cents per minute on outWATS services and 19.5 cents per minute on inWATS (800) services to any customer who makes an intraLATA call using one of the proposed, special access services.⁹

We find that this solution will minimize the competitive pressures on the local exchange carriers which would otherwise result from permitting petitioners to offer their statewide, high-volume services at a rate substantially less than the LECs are charging for intraLATA

8/ Testimony at the hearing indicated that some carriers are providing intraLATA toll service by reselling originating and terminating access services in violation of LEC tariff restrictions. Tr. I, 106-107, Tr. II, 25-26, 296-298. Because of recent LEC rate reductions, however, it is not clear whether these resellers represent a competitive threat to the LECs. The reseller pays an average of 15.5 cents per minute in access charges to complete an intraLATA call. See Tr. II, 26. Since the hearing, the Commission has reduced the cost of an average intraLATA WATS minute to 18 cents (Docket U-88-7547), squeezing a reseller's ability to underprice Bell, cover his own costs, and still earn a profit. The resellers have also been accused of mislabeling intrastate calls as interstate traffic, thereby avoiding the higher, intrastate CCLC. Bell stated at the hearing, however, that the company is now taking stronger action to insure that resellers accurately report and pay for intrastate usage. Tr. II, 26-30, 38-43. The Commission assumes that Bell will enforce its tariffs but makes no decision at this time what action should be taken in regard to intraLATA resellers. Tr. II, 297-298. See p. 23, para. 7, *infra*.

9/ Bell's average WATS rate is 18 cents per minute; the average rate for 800 service is approximately 19.5 cents. United Inter-Mountain's rates are approximately the same. Tr. Vol. II, 190.

toll calls. If all carriers are required to charge the same rate for intraLATA service, a customer's decision whether to choose an IXC or LEC service would depend upon the customer's calling pattern. Because of Megacom's high installation costs, a customer who makes a substantial number of intraLATA calls will not likely abandon his Bell WATS line for Megacom. On the other hand, a large customer who makes mostly interstate and interLATA calls will probably subscribe to one of the proposed tariffs and no longer use LEC toll services.

InterLATA rates for the proposed service will be set in accordance with existing Commission policies. AT&T's rates for Megacom and Megacom 800 will be "capped" at the same rate as the carrier's existing WATS and 800 services. The carrier may reduce those rates at any time, however, without regulatory approval. No interLATA rate will be set for MCI or Sprint. See Docket U-84-7311, April 19, 1985, at pages 7-9.

/ In conclusion, the Commission finds that intraLATA competition is not in the public interest at this time. Nevertheless, the Commission recognizes that the proposed tariffs will provide better and cheaper service to large volume customers and that it is apparently not practical to adapt these services to interLATA use. Therefore the Commission authorizes the petitioners to market and provide the services included within the proposed tariffs on a statewide basis as long as the IXCs charge for intraLATA

usage no less than 18 cents per minute (the average, LEC WATS rate) for outWATS services and no less than 19.5 cents per minute for inWATS (800) service. / Under the circumstances before us, we find that these are "just and reasonable" rates for intraLATA calls. See T.C.A. 65-5-201.

Each IXC must file an amended tariff consistent with this Order, indicating the rates set forth above for intraLATA usage. At the same time, the IXC must submit for Commission approval a plan to implement these billing requirements.¹⁰ No IXC may begin providing the proposed services until the Commission has approved the amended tariffs and billing plans.

V. COMPENSATION AND ACCESS CHARGES

The second condition imposed on petitioners is designed to insure that these new services do not result in lower toll costs for large volume users at the expense of local ratepayers. There are two aspects to this issue: (1) the collection of interLATA access charges associated with the completion of an interLATA call and (2) the payment of compensation to the LECs for the completion of intraLATA calls. Both schemes are intended to require toll users to contribute to the costs of maintaining the local exchange

^{10/} If an IXC cannot readily adjust its billing system to separate intraLATA calls, the carrier may file an interim proposal to charge for intraLATA usage based on a representative sampling of a customer's traffic. Such a plan will be approved only until January 1, 1989.

network in order to keep residually priced, local service rates as low as possible. We will address each plan separately.

A. InterLATA Access Charges

As described in part I, Megacom and Megacom-like services require a direct connection between the Megacom customer and the IXC's network, thus bypassing the local company's switching equipment at the customer's end of the call and allowing the toll carrier to avoid paying switched access charges. Those fees compensate the local carriers for the costs of handling toll calls and also provide a contribution, called the Carrier Common Line Charge ("CCLC"), to local exchange services.¹¹

/ The Commission designed the access charge system to maintain, at pre-divestiture levels, the relative balance between the price of intrastate toll calls and local service rates. In practice, however, the system is gradually forcing long distance customers to pay an increasingly larger share of the total costs of telephone service. ✓

Over the last four years, interLATA toll usage has increased at an annual rate of 12% to 15%. During the same time, the total number of telephone subscribers (measured by the number of LEC access lines) has grown at a rate of only

^{11/} This contribution is usually referred to by IXC witnesses as a "subsidy" to local service rates. Whether toll rates, in fact, subsidize local services--or visa versa--is subject to controversy which we need not resolve. See Docket U-83-7261, Order of March 4, 1985 at p. 5 n. 2. The proper balance between local and long distance rates is a public policy question, not a debate over cost allocation. See Part V.

3.5% to 4%. Since access charges are paid by the minute, LEC access revenues have been growing much faster than the number of LEC subscribers; in other words, the contribution collected from toll users to support local rates is growing faster than the number of local ratepayers. As these trends continue, local rates may shrink but only at the increasing expense of long distance customers. Tr. II, 413-414.

To address the bypass issue and to prevent the gradual shifting of costs from local to long distance customers, AT&T proposed in rebuttal testimony that the Commission change its method of collecting access charges. Tr. II, 409-415.

The carrier suggested that the LECs levy a flat fee on each toll provider. The amount of the fee would be calculated to provide a fixed amount of contribution each year for every local access line regardless of any increase or decrease in the amount of toll traffic or the introduction of bypass services.

Following the hearing, the parties met several times in an effort to determine whether they could agree on the AT&T proposal or some other type of flat-rate proposal. As a result of those meetings, the Staff recommends the adoption of the interLATA access charge plan described in the Appendix to this Order.

In summary, the plan requires each LEC to adjust annually its Common Carrier Line Charge to maintain a fixed amount of access revenue per LEC access line. As long as

toll minutes continue to increase faster than access lines, the plan will result in annual reductions in intrastate rates for switched access.

The Commission has reviewed the proposal and approves it. We find that it will maintain the IXCs' contribution to the local network while keeping intrastate toll rates at a reasonable level. As we have done in the past, we will require AT&T to file revised tariffs passing on to its customers any reduction in intrastate access charges. Tr. II, 110. By holding toll rates down, the Commission can reduce the threat of uneconomic, private bypass¹² and keep Tennessee's rates more in line with interstate charges. Adoption of this plan does not foreclose the Commission from ordering further changes in the CCLC rates or AT&T's long distance rates as the result of other regulatory proceedings.

B. IntraLATA Compensation

/ The Commission will make no changes in the present intraLATA compensation scheme adopted in Docket U-83-7261. See Order of August 30, 1985./ The plan requires the IXCs operating in Tennessee to report and pay compensation to the LECs for all intraLATA calls completed over IXC facilities.¹³ The amount of compensation is calculated by

12/ Uneconomic bypass occurs when artificially high prices for network facilities drive customers to build their own telephone systems. See Docket U-83-7261, Order of March 4, 1985, at 5-6; Tr. II, 262-263.

13/ All intraLATA toll revenues and IXC compensation payments are kept in a common fund, called the intraLATA pool, administered by South Central Bell. Bell and the other local exchange carriers operating in that LATA divide

adding the originating and terminating, switched access charges which the interexchange carrier would have paid if the call had crossed a LATA boundary. As applied to Megacom and other bypass services, the plan will require payment of switched access charges at both ends of a toll call whether or not the call traveled over a special access line or other bypass facility.

The Commission determined in 1985 that the payment of switched access would approximately reimburse the local carriers for their lost toll revenue. Tr. II, 15-16, 217-219. The Commission reaffirms its policy of having the LECs "break even" by recovering their lost toll revenue, that is, the revenue lost from WATS and 800 service. Although the Commission has reduced switched access charges since 1985 (and will likely continue to reduce them under the plan proposed by the staff discussed above), the agency has also ordered reductions in LEC toll rates. Based on today's rate schedules, we again find that the LECs will approximately break even by trading a minute of toll

the fund among themselves according to the terms of an agreement negotiated among the pool members. See Docket U-83-7261, Order of August 30, 1985, at 9, n.6.

revenue for a minute of switched access charges.¹⁴ There is no reason to change the 1985 formula.

Some parties have suggested that a flat rate access plan should also be applied to intraLATA calls Tr. II, 410-411. We do not agree.

First, there is no reason to develop intraLATA access charges as long as the Commission continues to prohibit intraLATA competition. As the MCI witness explained, such charges are necessary to insure that intraLATA competition works fairly, that both LEC and IXC toll services make an equal contribution to local exchange costs. Tr. I, 292-298. As long as intraLATA toll

14/ At present access rates, interexchange carriers must pay approximately 15.5 cents per minute as compensation to the LECs for each intraLATA toll call carried over IXC facilities. (The IXCs receive a credit against this amount for all switched access charges actually paid in conjunction with the call.) The cost of an average minute of Bell's intraLATA WATS service, the service most vulnerable to competition from Megacom and similar offerings, is approximately 18 cents. Bell, of course, saves some billing costs when an IXC handles an intraLATA call and also saves long run switching costs if the IXC customer subscribes to special access. Tr. I, 284, 289, 308. It is not practical or necessary to calculate these savings exactly. Any gain or loss to the LECs should be relatively insignificant and can be handled through traditional ratemaking proceedings. See Order of August 30, 1985, at 9, stating that this reimbursement plan "is relatively easy to implement and avoids a number of problems which would arise if the Commission attempted to calculate the actual revenue lost (or costs saved) each time an intraLATA call is completed over the [IXC] network."

Over time, the compensation rate should gradually decrease as the result of reductions in interLATA access charges. The reduced compensation rate should be offset, however, by growth in the number of intraLATA toll minutes carried over IXC facilities. If there is any overall reduction in intraLATA compensation payments, the local carriers will have ample time to propose appropriate rate adjustments.

competition is prohibited, there is no need to require the LECs to file intraLATA access tariffs or for the Commission to address the cost-of-service issues such tariffs would raise.

Second, the concerns which persuade us to adopt a new method for the payment of interLATA access charges do not apply to the intraLATA market at this time. The Commission's intraLATA compensation arrangement is not affected by the introduction of bypass services because the plan requires the IXCs to pay both originating and terminating, switched access charges for every intraLATA call regardless of how the call is routed.¹⁵ Similarly, the Commission is not concerned whether intraLATA toll customers appear to be subsidizing local rates. LEC rates

^{15/} This illustrates the difference between the interLATA access charges described in Part A and the intraLATA compensation plan described in B. Under the interLATA system, the IXCs pay switched access charges whenever a toll call passes through an LEC switch. They pay nothing, however, if the call is routed over customer-provided, special access facilities. To make up for revenues lost through bypass, the switched access charges will be increased, if necessary, to insure that the IXCs' total access payments (per LEC access line) remain at present levels.

The intraLATA plan, by contrast, requires an IXC to pay compensation for each intraLATA call whether or not the call is routed over a special access line or through an LEC switch. Regardless of the type of service, the routing of the call, or the nature of the carrier (certified IXC or reseller), the service provider must pay both originating and terminating access charges to the local exchange carriers (the intraLATA pool).

To enforce this plan, we will require each petitioner to report to the LECs all intraLATA calls carried over one of the new services. LEC tariffs should also require each IXC to report such traffic. Based on those reports, the local carriers can calculate and charge the appropriate amount of compensation, depositing all compensation payments in the intraLATA pool.

are not cost-based (see n. 10, supra), but any perceived imbalance between LEC toll and local rates can be adjusted by the LECs themselves through tariff filings or by the Commission through toll rate reductions.

When and if the Commission changes its policy on intraLATA competition, we will reconsider intraLATA access charges and the flat rate proposal.

IT IS THEREFORE ORDERED THAT:

1. The proposed tariffs are hereby approved subject to the terms and conditions described in this Order;
2. IntraLATA competition is prohibited;
3. The petitioners may begin marketing and providing the proposed services on a statewide basis upon the filing and approval of revised tariffs reflecting a usage rate for intraLATA toll calls of no less than 18 cents per minute for outWATS services and no less than 19.5 cents per minute for inWATS services and upon the filing and approval of a plan to implement this billing arrangement;
4. The petitioners must report and pay compensation, as described in Part V, for any intraLATA calls made through these new service offerings;
5. The local exchange carriers under the Commission's jurisdiction shall file revised access tariffs implementing the access charge plan described in the Appendix and shall implement the intraLATA compensation plan described in Part V of this Order.

6. The interLATA access charge plan shall become effective January 1, 1989, except that a local exchange carrier may, upon Commission approval, implement the plan at an earlier date;

7. Within thirty days of the date of this Order, the Commission Staff shall file a report with the Commission describing what efforts the Staff and the local exchange carriers have made to insure that all carriers operating in Tennessee are reporting intrastate traffic and paying intrastate access charges in accordance with LEC tariffs and the Commissions orders;

8. Upon petition of any interested person, but - in any event - no earlier than April 1, 1989, and no later than January 1, 1992, the Commission will re-examine the conclusions reached in this Order including the interLATA and intraLATA compensation plans and the issue of intraLATA competition;

9. Any party aggrieved with the Commission's decision in this matter may file a Petition for Reconsideration with the Commission within ten (10) days from and after the date of this Order;

10. Any party aggrieved with the Commission's decision in this matter has the right of judicial review by filing a Petition for Review in the Tennessee Court of

Appeals, Middle Section, within sixty (60) days from and after the date of this Order.


CHAIRMAN


COMMISSIONER


COMMISSIONER

ATTEST:


EXECUTIVE DIRECTOR

Appendix

1. Beginning January 1, 1989 and each succeeding year each LEC will reduce its CCLC rates¹ by the amount its access minutes of use (MOU) growth rate² exceeds the growth rate of its access line³ for the twelve months ended the previous June 30.

[e.g. If an LEC's average access lines for the twelve months ended June 30, 1988 is 4% greater than its average access lines for the twelve months ended June 30, 1987, and its MOUs for the twelve months ended June 30, 1988 are 9% greater than its MOU for the twelve months ended June 30, 1987, the LEC will reduce its CCLC rates by 5%, $(4\% - 9\% = -5\%)$.]

Correspondingly, if the access line growth exceeds the MOUs growth rate the CCLC rate will be increased.

[e.g. If the access line in the example above is 8% while MOU growth is 6% the CCLC will be increased by 2% $(8\% - 6\% = 2\%)$.]

2. When the access line growth is negative, an access line growth rate of zero will be used in the above formula.

1/ The same factors will be applied to the originating and terminating CCLC rates.
2/ As determined by the growth in that company's originating and terminating CCLC minutes.
3/ Access line as defined by NECA.

In subsequent years all reductions in access lines (negative access line growth) will be completely offset before reflecting a positive access line growth rate in the above formula.

3. In lieu of the methodology outlined in item 1, the Local Exchange Carrier may propose a change in the Carrier Common Line Charge rate as a rate filing that will be handled in accordance with normal Commission procedures.
4. The adjusted CCLC rate will not be reduced below the interstate CCLC rate prescribed by the FCC.
5. Each LEC will file the adjusted CCLCs as described in (1) by October 1 of each year based on the growth rate from the twelve months ended June 30 of the current year. The revised rates will be effective the following January 1. In setting rates for the LECs the Commission will make appropriate adjustments to reflect the impact of any increase or decrease in CCLC revenues.
6. By December 1 of each year AT&T will file revised long distance tariffs to be effective January 1 reflecting the savings as a result of the CCLC reduction.
7. With Commission approval, an LEC may elect to reduce its CCLC effective July 1, 1988 based on growth rates for the twelve months ended March 31, 1988. The LEC must file its revised rates by April 15, 1988. AT&T must file its revised long distance tariffs by June 15,

1988. A July 1, 1988 CCLC reduction will not excuse the LEC from filing again in October, 1988.

8. The Commission intends to conduct an in depth review of the plan no later than January 1, 1992.

BEFORE THE TENNESSEE PUBLIC SERVICE COMMISSION
NASHVILLE, TENNESSEE

February 20, 1990

IN RE: TARIFF FILING BY SOUTH CENTRAL BELL TELEPHONE COMPANY TO
REFLECT THE ANNUAL CCLC ADJUSTMENT

DOCKET NO. 89-15385

FILE COPY

ORDER

This matter is before the Commission at the request of AT&T Communications of the South Central States, Inc. (AT&T) which protested a tariff filed by the South Central Bell Telephone Company (Bell) to reduce Bell's intrastate common carrier line charge (CCLC). Bell filed the tariff (number 89-217) to adjust the CCLC in accordance with a formula prescribed by the Commission in Docket U-87-7492 (the Megacom order) issued on March 17, 1988. Believing that Bell had misinterpreted the Megacom formula, AT&T protested the tariff and sought a hearing.

The matter was heard on January 9, 1990, by Commissioners Bissell, Hewlett, and Cochran. After hearing testimony from witnesses for Bell, AT&T, and the Commission Staff, the Commission agrees with AT&T that Bell's tariff should be amended to reduce the Bell's CCLC revenues by \$2.3 million. /1

In support of its decision, the Commission makes the following findings of fact and conclusions of law.

/1 This will reduce CCLC rates to \$.0233 on originating calls and \$.0437 on terminating calls.

EXHIBIT

tabbies
2

As explained by Staff witness Burcham, the CCLC is paid by AT&T and other toll providers (IXCs) to local exchange carriers (LECs) to compensate them for the fixed costs of maintaining the local telephone network. CCLC charges are collected on a per minute basis at both the originating and terminating ends of most IXC toll calls. Thus, as toll minutes grow, CCLC revenues grow proportionally. If toll minutes grow at a faster rate than the number of LEC customers (access lines), toll customers will pay -- over time -- an increasingly larger share of LEC fixed costs. The purpose of the Megacom formula was to "cap" CCLC revenues per LEC access line. To accomplish that result, the formula stated that each LEC should make an annual adjustment in its CCLC based on the difference, if any, between the growth rate in intrastate toll minutes and the growth rate in LEC access lines.^{/2} The Megacom decision also recognized that the Commission might adjust the CCLC in the course of other rate proceedings. Those rate adjustments might increase or decrease the "cap."

This dispute arose because, on January 1, 1989, the Commission reduced to zero the CCLC on the originating end of WATS calls and on the terminating end of "800" calls. In making this reduction, the Commission's goal was to lower Bell's intrastate revenue, not to shift CCLC charges from one group of toll customers to another.

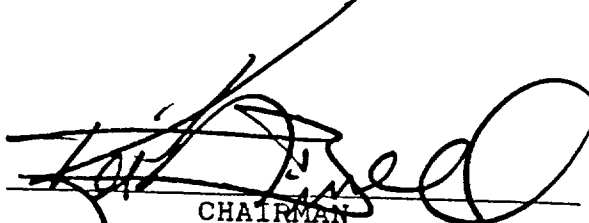
^{/2} The formula does not maintain the cap precisely at its original level. We approved it because all parties agreed that the formula was easy to apply and approximated the desired result.

Bell, however, has interpreted the Megacom formula in a manner which, in effect, will shift to other toll customers the CCLC charges formerly paid by WATS and 800 customers. In calculating the growth in toll minutes during the twelve month period ending June 30, 1989, Bell failed to count those WATS and 800 minutes for which no CCLC was collected. This, of course, produced a lower toll growth rate and, under the formula, a higher CCLC. The Staff supports Bell's interpretation of the Megacom formula which, read literally, requires Bell to count only those toll minutes to which a CCLC applies. The Staff acknowledged, however, that this formalistic approach produces a result inconsistent with the purpose of the Megacom order.

Under these circumstances, the Commission agrees with AT&T that Bell's tariff, as filed, must be modified to reflect the intent of the Megacom order. In calculating the growth in toll minutes between the twelve month period ending June 30, 1988, and the twelve months ending June 30, 1989, whatever CCLC minutes were counted during the first period must also be counted during the second twelve months. Since all WATS and 800 minutes were counted in the twelve month period ending June 30, 1988, they must also be counted during the following period for purposes of calculating a growth rate under the Megacom formula. Future tariff filings under

the formula should be consistent with this Order. /3

It is so ordered.


CHAIRMAN


COMMISSIONER


COMMISSIONER

ATTEST


EXECUTIVE DIRECTOR

/3 Next year, Bell must compute the growth in toll minutes between the twelve month period ending June 30, 1989, and the period ending June 30, 1990. Since all WATS and 800 minutes were counted during the first six months of the base period, they should all be counted (or estimated) during the first six months of the second period. Two years from now, Bell will compare the toll minutes recorded in the twelve-month period ending June 30, 1990, with the toll minutes recorded in the period ending June 30, 1991. Originating WATS calls and terminating 800 calls will not be counted in either period.

Nothing in this Order, however, is intended to resolve the issue of how changes in the PIU (percentage of interstate usage) should affect the Megacom formula. If the parties cannot agree on his question, the Commission will address it at a later date.

**BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE**

November 24, 1998

IN RE: UNITED TELEPHONE-SOUTHEAST)
PETITION FOR DECLARATORY ORDER) DOCKET NO. 97-07628
REGARDING THE "MEGACOM" ORDER)

DECLARATORY ORDER

This matter came before the Tennessee Regulatory Authority (the "Authority") at the Authority Conference held on August 18, 1998, for consideration of the Petition for a Declaratory Order filed by United Telephone-Southeast, Inc. ("United").

I. Background

This Petition was filed by United on December 31, 1997, concerning applicability of the Order in Tennessee Public Service Commission (the "TPSC") Docket No. U-87-7492¹ (the "Megacom Order") as it applied to United, a price regulated entity under Tenn. Code Ann. § 65-5-209. A copy of the Megacom Order is attached as Exhibit A.

In order to originate and terminate long distance calls over the local exchange company ("LEC") network, interexchange carriers ("IXC") pay access charges to the LECs. In the Megacom Order, the TPSC determined that IXCs should maintain their contribution to the local network via access charges, but also recognized the importance of reasonable intrastate toll rates. To accomplish this, the TPSC implemented a mechanism to adjust the carrier common line charge ("CCLC") rate, a component of access service, of LECs. These adjustments have

¹ In re: Tariff Filing by AT&T Communications to Establish Rates and Charges For Megacom and Megacom 800 Services, No. U-87-7492 (Tenn. Pub. Ser. Comm. March 17, 1988).



historically resulted in reductions of the access charges that IXC's pay to LEC's. The IXC's, in turn, pass these savings on to their customers through reduced intrastate toll rates. United asserted in its Petition that it, as a price regulated company under Tenn. Code Ann. § 65-5-209, should not be subject to the Megacom Order.

At a regularly scheduled Authority Conference on January 6, 1998, the Authority opened a contested case, and appointed the General Counsel or his designee to serve as Hearing Officer and set the procedural schedule. On February 12, 1998, BellSouth Telecommunications, Inc. ("BST") filed a Petition for Leave to Intervene in the proceeding. A Pre-Hearing Conference was held on March 12, 1998. At the Pre-Hearing Conference the Hearing Officer granted the intervention of BST and issued an Initial Order dated March 19, 1998.

II. Position of the Parties

a) United

United argued that the Megacom Order is not applicable to them with respect to annual CCLC changes due to its current form of regulation pursuant to Tenn. Code Ann. § 65-2-209. They also contended that the Megacom Order had been superseded because the Authority has ordered the implementation of intraLATA toll dialing parity since United entered price regulation.

United contended that the Authority has treated access charges as non-Basic services for price regulation purposes and that access charges may be priced at the Company's discretion in accordance with Tenn. Code Ann. § 65-2-209(h) which states, "Incumbent Local Exchange Companies subject to price regulation may set rates for non-Basic Services as the company deems appropriate[.]"

United argued that while the Megacom Order required telephone companies to adjust their rates according to an agency order, subsequently enacted statutes grant companies operating under price regulation the ability to price those same services “as the company deems appropriate.” United contended that the later enacted Tenn. Code Ann. § 65-2-209 prevails over a TPSC order. United further argued that a fundamental premise underlying the Megacom Order was the prohibition against intraLATA competition. Effective July 21, 1997, United implemented intraLATA Toll Dialing Parity in accordance with the Authority’s November 12, 1996 Order granting United its Certificate of Public Convenience and Necessity.² A copy of the Order granting United its Certificate of Public Convenience and Necessity is attached as Exhibit B. United contended that since this Order required United to implement intraLATA toll competition, the fundamental principle on which the Megacom Order was premised had been negated.

b) BellSouth

BellSouth presented the same arguments as United by contending that the price regulation statutes do not permit mandatory rate increases or decreases for access services like those imposed by the Megacom Order. Like United, BellSouth argued that access charges are non-Basic services and that Tenn. Code Ann. § 65-5-209(h) allows local exchange carriers operating under price regulation to set rates for such services as the company deems appropriate. BellSouth also presented an argument stating that access charges clearly do not fit into the statutory definition of basic local exchange telecommunications services, and therefore, must be treated as non-Basic services.

² In re: Application of United Telephone Southeast, Inc., For a Certificate of Public Convenience and Necessity to Provide InterLATA Interexchange and Telephone Service Within Tennessee, No. 96-01235, at p. 3 (Tenn. Reg. Authority June 6, 1997)

IV. Findings and conclusions

This matter came before the Directors at a regularly scheduled Authority Conference held on August 18, 1998. At that Conference the Directors found that since the issuance of the Megacom Order major changes have occurred regarding the regulatory framework under which price regulated companies operate. As a rate of return regulated utility United was required to make certain annual access rate adjustments in accordance with the Megacom Order. Under Tenn. Code Ann. § 65-5-209(g) United is permitted an annual adjustment in the rates for interconnection services based on the indexing method contained within the statute.

Upon consideration of the Petition for Declaratory Order and the record in this matter the Directors determined that Tenn. Code Ann. § 65-5-209(g) read together with Tenn. Code Ann. § 65-5-209(h) and other provisions of Tennessee law supersede the access rate adjustments required by the Megacom Order. Further, on November 12, 1996, United implemented toll dialing parity removing restrictions on intraLATA competition, a fundamental basis for implementing the required annual access rate adjustment in the Megacom Order. Therefore, the Directors determined that as a price regulated entity and the Petitioner in this matter, United is no longer subject to the Megacom Order. The Directors unanimously approved United's Petition for Declaratory Order.

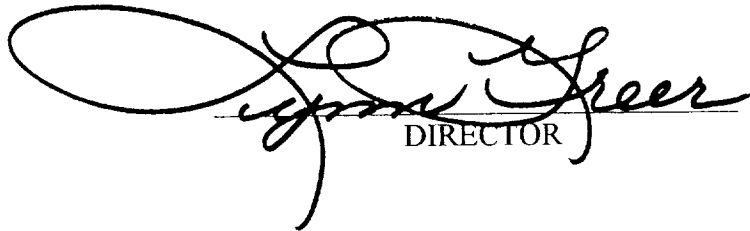
IT IS THEREFORE ORDERED THAT:

1. The Petition for Declaratory Order of, and pertaining to, United Telephone-Southeast, Inc. is approved;
2. Any party aggrieved by the Authority's decision in this matter may file a Petition for Reconsideration with the Authority within ten (10) days after the date of this Order; and

3. Any party aggrieved by the Authority's decision in this matter has the right of judicial review by filing a Petition for Review in the Tennessee Court of Appeals, Middle Section, within sixty (60) days from the date of this Order.


CHAIRMAN


DIRECTOR


DIRECTOR

ATTEST:


EXECUTIVE SECRETARY